Supreme Court, U.S.
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No. 01-888

In The

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; AND TICKNOR LODGING CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF

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ARGUMENT

I. THE NINTH CIRCUIT'S FAILURE TO COMPLY WITH THE REQUIREMENTS OF *ERIE* AND *KLAXON* RESULTED FROM ITS FAILURE TO APPLY THE CORRECT RULE OF STATE LAW, NOT FROM A MISINTERPRETATION OF A CORRECTLY STATED RULE OF LAW.

Respondents in their opposition attempt to characterize Choice's argument as one complaining about a determination by the Ninth Circuit that was based upon a "properly stated rule of" Montana law, citing *Meredith v. City of Winter Haven*, 320 U.S. 228, 236 (1943) for the proposition that "[f]ederal courts have a duty to apply state law even where that state law is 'uncertain or difficult to determine.' " Respondents miss completely the point of Choice's argument. Choice's position in this case is not based upon the incorrect application by the lower court of a correctly stated rule of law; rather, Choice seeks review of a judgment that was the result of a failure by the Ninth Circuit to apply Montana law. Contrary to what respondents assert, Montana law does not hold arbitration clauses contained in commercial contracts between sophisticated business entities, as opposed to consumer contracts, to be unconscionable. In *All-States Leasing Company v. Top Hat Lounge, Inc.*, 198 Mont. 1, 6, 649 P.2d 1250, 1253 (1982), the Supreme Court of Montana stated that "[a]lthough courts have readily applied the doctrine of unconscionability to contracts between consumers and skilled businessmen, they are reluctant to rewrite the terms of a contract between businessmen themselves." This is clearly the law relating to unconscionability in Montana as it relates to contracts between

business entities. In ignoring it, the Ninth Circuit disregarded existing state law, and did not merely "misapply" it by reaching an incorrect decision based upon a correctly stated principle of Montana law. In doing so, the lower court disregarded the principles established in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938) and *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941).

Respondents suggest that the Ninth Circuit "had no opportunity to address" the argument raised by Choice below to the effect that *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989 (1999) did not set forth Montana law with respect to the enforceability of arbitration clauses in contracts between business entities, as opposed to contracts between a business entity and a consumer, because Choice did not specifically cite *All-States Leasing* in its briefs. Contrary to the suggestion by respondents in their opposition, Choice did argue this point in its brief, and the dissenting member of the panel below pointed out the error by the panel majority on this issue. Further, the panel majority showed it was familiar with that case, as it cited the decision in its own opinion and was presumably aware of its holding, and respondents cite no authority for the proposition that, because Choice failed to cite a particular case in its briefs below, the Ninth Circuit was free to disregard the principle of law set forth in that case.

Respondents argue that the Ninth Circuit correctly determined "how the highest court of Montana would decide an issue of state law which was not addressed in existing precedent." Brief in Opposition to Petition, p. 13. As indicated above, however, the lower court specifically disregarded existing precedent from the Montana

Supreme Court indicating a disinclination to apply the doctrine of unconscionability to contracts between businessmen. This was the "properly stated rule of law" that should have been applied by the Ninth Circuit, and its refusal to acknowledge this precedent and to apply it in evaluating the arbitration clause between the parties in the instant case constituted both error and a basis for granting certiorari. *See Leavitt v. Jane L.*, 518 U.S. 137, 144-145 (1996).

With respect to the reliance by the Ninth Circuit on *In re Michael's Estate*, 264 Mont. 261, 871 P.2d 272 (1994), respondents claim that the decision "spelled out the test" for the application of the doctrine of unconscionability in contracts between businessmen; however, even if *In re Michael's Estate* were to be considered the precedent upon which the Ninth Circuit relied in its attempt to "find" state law, it would not support the result in the instant case, for *In re Michael's Estate* merely states that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals." Completely absent from that case is any statement that "lack of mutuality of obligation" could somehow constitute a basis for invalidating any contract, much less an arbitration agreement.

Although respondents cite *Spiegel's Estate v. Comm'r*, 335 U.S. 701 (1949) for the proposition that it is the "general policy" of this Court to "leave undisturbed" holdings with respect to state law, that case also establishes that this Court will not only review lower court decisions purporting to apply what is felt to be the law of a particular state, but also that if the decision is wrong, it may be reversed.

II. THE CONFLICTS BETWEEN THE OPINION OF THE NINTH CIRCUIT AND DECISIONS OF THIS COURT, INCLUDING *CASAROTTO*, ARE BOTH SIGNIFICANT AND IRRECONCILABLE.

This Court has held that the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, does not "prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement." *Volt Information Sciences, Inc. v. Board of Investments*, 489 U.S. 468, 478 (1989); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). Even assuming that *Iwen* correctly states the law relating to contracts involving business entities in a commercial setting, it is clear that a requirement that there be "mutuality of obligation" in an arbitration contract would run directly contrary to that principle. State courts may not, in interpreting arbitration agreements subject to the Federal Arbitration Act, scrutinize such contracts in an attempt to determine whether or not a sufficient number or type of claims may be brought in arbitration by either party to the contract without running afoul of the principles set forth in *Volt* and *Mitsubishi*, nor may a state court attempt to engage in such a practice by engrafting onto existing state law a requirement that there be "mutuality of obligation" in an arbitration contract in order for that contract to survive an unconscionability objection.

With regard to Choice's point that the Ninth Circuit's decision was contrary to the principles of *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), respondents once again suggest that Choice's argument "is simply that there has been a misapplication of a properly stated rule of law." Brief in Opposition to Petition, p. 16. Once

again, however, respondents misstate both Choice's position and the holding of the Ninth Circuit. The lower court specifically relied upon the "mutuality of obligation" language of *Iwen* in invalidating the arbitration clause in the instant case, even going so far as to point out the ways in which it believed that arbitration clause lacked such mutuality. While Choice asserts that the "mutuality of obligation" requirement added onto the law of unconscionability by the court in *Iwen* does not set forth the law with respect to commercial contracts between business entities, and that the Ninth Circuit erred in finding that it did, even if that principle were properly stated and applied, it is a principle that the court in *Iwen* could not have applied solely to arbitration contracts without violating the rule established in *Casarotto*. As demonstrated above, and contrary to the repeated assertion by respondents that the Ninth Circuit opinion relied solely upon the "unconscionability" principles of Montana law, both *Iwen* and the Ninth Circuit went beyond general unconscionability principles under Montana law in their holding invalidating the arbitration clauses in question. As a result, there is a clear conflict between the decision of the Ninth Circuit and *Casarotto*.

III. THE CONFLICT BETWEEN THE NINTH CIRCUIT AND OTHER CIRCUITS CANNOT BE EXPLAINED AWAY OR IGNORED.

In their opposition, respondents submit that there is no conflict between the opinion of the Ninth Circuit in the case below and the decisions of courts in other circuits cited in Choice's petition, arguing that the "Ninth Circuit did not find the arbitration clause at issue to be

unenforceable solely on the basis of a lack of mutuality of obligation. It found it to be unconscionable because it was, *inter alia*, 'unreasonably favorable to the drafter.' " Brief in Opposition to Petition, p. 7. What respondents ignore, however, is that portion of the Ninth Circuit's opinion that indicated what the panel majority believed to be the law on this issue, as set forth in *Iwen*. The following quotation from the Ninth Circuit's opinion, which sets forth its holding, definitively refutes the interpretive gloss respondents wish to place upon that opinion in an attempt to reconcile it with those of other circuits:

> The arbitration clause in this case allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland. *Iwen* involved an almost identical situation, leaving the Montana Supreme Court to reach the conclusion that the clause was unenforceable. Thus, applying *Iwen*, the arbitration provision in this case "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter."

App. 14; citations omitted. Leaving aside for the moment the issue of whether *Iwen* sets forth the law relating to unconscionability with respect to an arbitration clause entered into between sophisticated business parties, as opposed to what may fairly be characterized as a consumer contract (and Choice contends it does not), it is plain that *Iwen* would only permit an arbitration clause to

be held unconscionable if it "lacks mutuality of obligation, is one-sided, *and* contains terms that are unreasonably favorable to the drafter." (Emphasis supplied.) *Id.* at 977 P.2d 996. App., p. 10. This statement from *Iwen* is clearly phrased in the conjunctive, not in the disjunctive, and requires that all three elements, i.e., lack of mutuality of obligation, one-sidedness, and terms that are unreasonably favorable to the drafter, be present before a finding of unconsionability is made. In light of the foregoing, along with the statement by the panel that the arbitration clause "allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland," it is clear that the holding by the lower court was based upon an alleged lack of mutuality of obligation; indeed, in the absence of such a finding, it is obvious that the Ninth Circuit would not have been applying the Montana law it found to be expressed in *Iwen* in any event, making its judgment defective for that additional reason. As a result, respondents' characterization of the lower court's opinion is manifestly inaccurate.

The principal basis upon which respondents seek to distinguish the cases cited by Choice as conflicting with the decision of the Ninth Circuit of the case at bar appears to be respondents' perceived distinction between the "mutuality of obligation" concept referred to by the lower court and the concept of "lack of consideration." As indicated in Restatement (Second) of Contracts § 79, however, if "the requirement of consideration is met, there is no additional requirement of . . . (c) 'mutuality of obligation.' " Comment f to that section goes on to state

that the "word 'mutuality,' though often used in connection with the law of contracts, has no definite meaning," and refers to the "confusion caused by treating mutuality as a separate concept" from lack of consideration. *See also, F. Jacobus Transportation Co., Inc. v. Gallagher Brothers Sand & Gravel Corp.*, 161 F. Supp. 507 (S.D.N.Y. 1958) (stating that "the material inquiry in an action at law is not whether there is 'mutuality' but whether there is consideration to support the other party's promise"), citing, *inter alia, Meurer Steel Barrel Co., Inc. v. Martin*, 1 F.2d 687 (3rd Cir. 1924) and 1 Williston, *Contracts* § 105 A (3d ed. 1957). As a result, it is apparent that the statement by the lower court that the arbitration clause "lacks mutuality of obligation" is, in reality, a statement to the effect that there was a want of consideration. Under the circumstances, any distinction of the conflicting decisions in other circuits on such a basis would be inappropriate.

Respondents attempt to generalize the holding of the Ninth Circuit, suggesting that it concerned the "issue of unconscionability," and further suggesting that an "unconscionability analysis is a question of state law." What respondents fail to do, however, is to show that general contract principles relating to the presence, absence or adequacy of consideration would vary from state to state, and that such a variance would account for the differences between the authorities from other circuits cited by Choice and the holding of the court below. As indicated by Choice in its petition, the holding of the Ninth Circuit below was, in fact, at odds with even Montana law, which will not permit the invalidation of a

contract due to a perceived inadequacy of consideration, a principle of general applicability among the states.

In their effort to distinguish the conflicting decisions in other circuits, respondents attempt to cast those decisions, as they did with respect to the Ninth Circuit opinion below, in different terms. For example, respondents assert that the Fourth Circuit in *O'Neil v. Hilton Head Hospital*, 115 F.3d 272 (4th Cir. 1997) "did not even address an argument that the arbitration agreement was unconscionable," though they note that the argument of "lack of consideration" was raised. Respondents ignore the fact that it was the supposed lack of consideration resulting from an alleged want of mutuality of obligation that led the Ninth Circuit to hold that the arbitration clause in the instant case was unconscionable. Respondents also fail to point out that, as with the parties in *O'Neil*, both Choice and respondents were bound by the arbitration clause in question. The lower court did not in any way suggest that Choice could have refused to arbitrate claims brought by respondents or that, having arbitrated them, Choice could have declared itself not to be contractually bound by the result. The court in *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634, 636 (7th Cir. 1999) also found that the promise of *Circuit City* to be bound by the arbitration process served as "mutual consideration." Once again, in light of the generally accepted modern view of the relationship between the concepts of mutuality of obligation and consideration, it is plain that an argument based upon lack of consideration is not substantively different from one asserting lack of mutuality of obligation.

While respondents assert that the decision in *Kroll v. Doctor's Associates, Inc.*, 3 F.3d 1167, 1170 (7th Cir. 1993) "has nothing in common with the Ninth Circuit opinion," the following characterization by the Seventh Circuit of the contentions of plaintiff in that case belie that assertion: "*Kroll* contends that, even if the arbitration provision is applicable, it lacks mutuality and thus is unenforceable." As is clear from the portion of the decision of the Ninth Circuit quoted above, lack of mutuality of obligation was the reason ultimately given for not enforcing the arbitration clause between the parties. Accordingly, the distinction proffered by respondents is contradicted by a comparison of the very language of *Kroll* and the decision below.

CONCLUSION

In light of the foregoing, petitioner Choice Hotels International, Inc. once again requests that the petition for writ of certiorari be granted.

Respectfully submitted,

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